Performance Presentation Standards – Current Situation and Trends

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Portfolio performance is probably the most important marketing feature for the investment industry. Journals and other media present rankings of outperforming funds. Performance seems to be the key-figure of an investment-decision. Therefore, the misuse of historical performance data was/is pre-programmed.[1]

Traditionally, performance reports for portfolio managers have been based on quarterly data over 5 to 10 years. Currently, managers of mutual funds are required to disclose the exact composition of their portfolios only quarterly.[2] Trading activity that immediately precedes the reporting date is known as "window dressing". Window dressing involves changes in portfolio composition to make it look as if the manager chose successful stocks. There is no published evidence to substantiate the allegation, but if window dressing is quantitatively significant, even the reported quarterly composition data can be misleading. Mutual funds publish portfolio values on a daily basis, which means the rate of return for each day is publicly available, but portfolio composition is not. Moreover, mutual fund managers have had considerable leeway in the presentation of both past investment performance and fees charged for management services. The resultant non-comparability of net-of-expense performance numbers has made it difficult for a meaningful comparison of funds.

The money management industry responded to demands for complete and easily interpretable data on historical performance. The first general

1 Misuse can occur for example by "cherry-picking" (i.e. presentation of selected portfolios, presentation of selected time-intervals, etc. (see chapter 3.1.2)).

2 The description of the present situation is written according to Bodie, Kane and Marcus, 1986, p.798

standards came into force in the US in the late 1980s.[3] The so called Performance Presentation Standards (PPS), which were elaborated in the USA (by the Association for Investment Management and Research (AIMR-PPS)), consist of obligatory and facultative rules (guidelines and recommendations) to define and evaluate portfolios and investment instruments. Because the AIMR-PPS™ heavily rely on US conditions, the European Federation of Financial Analysts' Societies (EFFAS) in co-operation with AIMR developed international standards, the so called Global Investment Performance Standards (GIPS). GIPS provide a general agreement on performance presentation.
Meanwhile several countries adopted performance presentation standards. DVFA-Performance Presentation Standards (DVFA-PPS) for example are adopted as the country specific version for the German market.

The thrust of these Standards is that investment-firms are not allowed to "cherry pick" when presenting their performance history. To comply with the Standards a complete record of performance is required. Firms must present returns for all years, as opposed to strategically choosing a starting date that makes subsequent performance look best. It is also necessary to provide the investment performance of an index against which the performance of the portfolios may reasonably be compared. Similarly, composite results for the firm must include returns of all managers, even those who have since left the firm. The firm, therefore, may not ignore the results of its unsuccessful managers who have since been replaced. The firm, not the individual manager, has the responsibility for performance. Finally, the firm is encouraged to supply risk measures such as beta or duration to make risk-return trade-offs easier to evaluate. Although the Standards do not have the force of law, it nevertheless is expected that they will form the basis for industry performance presentation practices.

The Standards provide substantial advantages for investors, because they provide a standardised and objective basis to compare different investment

3 Financial Analysts Federation published first standards in 1987. These standards were the basis for AIMR-PPS, which came into force in 1993 (see chapter 2).

alternatives. Also they allow a professional choice of the "right" portfolio-manager.

Benefits of the Standards for the investment firm include the possibility for better global positioning. Also the firm can state its commitment to fair competition. The transparent presentation of the management style, the products and the historical performance are a marketing advantage in a world where information about investment alternatives is not easy to grasp.

The US- and the European surveys showed the widespread use of the Standards. In Austria the marketing advantage is not yet recognised, although most of the responding firms (within a specific Austrian survey) believe in a growing recognition of the Standards within the next years. Some firms are already near implementation of the Standards, or at least in a planning phase for introduction.

MAIN FEATURES:

- -> **Development of country specific and global Performance Presentation Standards (PPS)**
- -> **Presentation of the main contents of PPS**
- -> **Evaluation of the trends in performance measurement**
- -> **Comparison of Austrian Survey results to US and European results**